

**Audit of the Financial Management
Service's Fiscal Years 2002 and 2001
Schedules of Non-Entity
Government-Wide Cash**

OIG-03-039

December 23, 2002



Office of Inspector General

The Department of the Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

MEMORANDUM FOR RICHARD L. GREGG, COMMISSIONER
FINANCIAL MANAGEMENT SERVICE

FROM:

William H. Pugh, *William H. Pugh*
Deputy Assistant Inspector General
for Financial Management and Information
Technology Audits

SUBJECT:

Audit of the Financial Management Service's
Fiscal Years 2002 and 2001 Schedules of Non-Entity
Government-Wide Cash

I am pleased to transmit the audited Financial Management Service's (FMS) Fiscal Years (FY) 2002 and 2001 Schedules of Non-Entity Government-Wide Cash (the Schedules). The Schedules were audited by Clifton Gunderson LLP, an independent public accountant (IPA). The IPA issued the following reports, which are included in the attachment:

- Independent Auditor's Report;
- Independent Auditor's Report On Internal Control; and
- Independent Auditor's Report On Compliance with Laws and Regulations.

The IPA rendered an unqualified opinion on the FMS' FY 2002 and 2001 Schedules. However, as discussed in Note 3 to the Schedules, the balance of non-entity government-wide cash¹ as of September 30, 2001 was restated to correct an error in the balance of outstanding checks. This error resulted in an overstatement of cash of \$3.1 billion at September 30, 2001.

The Independent Auditor's Report on Internal Control contained the following two material weaknesses:

¹ Previously reported in OIG-02-060, *Audit of the Financial Management Service's Fiscal Year 2001 Schedule of Non-Entity Government-Wide Cash*, dated March 4, 2002.

- In the area of computer controls, there were numerous general controls weaknesses at the Hyattsville Regional Operations Center that did not effectively prevent (1) unauthorized access to and disclosure of sensitive information, (2) unauthorized changes to systems and applications software, (3) unauthorized access to certain programs and files, or (4) disruption of critical operations. In addition, the IPA's testing identified weaknesses in certain application controls.
- In the area of outstanding checks, the IPA noted that (1) until recently, FMS was unable to produce a detail of outstanding checks as of a given date, (2) FMS did not reconcile the balance of outstanding checks in the general ledger to the subsidiary system, (3) not all reconciling items affecting the general ledger were investigated and adjusted in the proper period, and (4) there were insufficient reconciliation procedures between certain systems that track check status related data.

The IPA's Report On Compliance with Laws and Regulations contained an instance of noncompliance relating to the Office of Management and Budget (OMB) Circulars A-127 and A-130, which require a comprehensive security plan, controls to protect information, and a fully developed and tested contingency plan.

My staff's review of the IPA's working papers determined that the work was performed in accordance with generally accepted government auditing standards. Should you have any questions, please contact me at (202) 927-5430, or a member of your staff may contact Louis C. King, Director, Financial Audits at (202) 927-5774.

Attachment

**DEPARTMENT OF THE TREASURY,
FINANCIAL MANAGEMENT SERVICE
Washington, DC**

**INDEPENDENT AUDITOR'S REPORTS
AND SCHEDULES OF NON-ENTITY
GOVERNMENT-WIDE CASH**

September 30, 2002 and 2001

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Independent Auditor's Report

To the Office of Inspector General
of the Department of the Treasury and the
Commissioner of the Financial Management Service

We have audited the accompanying Schedules of Non-Entity Government-wide Cash of the U.S. Department of the Treasury's Financial Management Service (FMS) as of September 30, 2002 and 2001. These schedules are the responsibility of FMS' management. Our responsibility is to express an opinion on these schedules based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and applicable provisions of Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements." Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the schedule is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the schedule. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall schedule presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the Schedules of Non-Entity Government-wide Cash referred to above present fairly, in all material respects, the balance of Non-Entity Government-wide Cash managed by FMS as of September 30, 2002 and 2001 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 3 to the Schedules of Non-Entity Government-wide Cash, the balance of Non-Entity Government-wide cash previously reported as of September 30, 2001 was restated to correct for a \$3.1 billion error in the balance of outstanding checks.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 1, 2002, on our consideration of FMS' internal control over financial reporting relating to Non-Entity Government-wide Cash and on our tests of FMS' compliance with certain

provisions of laws and regulations relating to Non-Entity Government-wide Cash. Those reports are an integral part of our audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Clifton Gunderson LLP

Calverton, Maryland
November 1, 2002

Independent Auditor's Report On Internal Control

To the Office of Inspector General
of the Department of the Treasury and the
Commissioner of the Financial Management Service

We have audited the Schedule of Non-Entity Government-wide Cash of the U.S. Department of the Treasury's Financial Management Service (FMS), as of September 30, 2002, and have issued our report thereon dated November 1, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and applicable provisions of Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements."

In planning and performing our audit, we considered FMS' internal control over financial reporting for Non-Entity Government-wide Cash by obtaining an understanding of relevant internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the schedule. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of the internal control over financial reporting for Non-Entity Government-wide Cash would not necessarily disclose all matters in the internal control over financial reporting for Non-Entity Government-wide Cash that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect FMS' ability to record, process, summarize, and report financial data consistent with the assertions by management in the schedule referred to above. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the schedule being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. We noted the following matters involving the internal control and its operation that we consider to be material weaknesses.

Effectiveness of Computer Controls

FMS relies on extensive information technology systems to administer Government-wide cash. Internal controls over these operations are essential to ensure the integrity, confidentiality, and reliability of critical data while reducing the risk of errors, fraud and other illegal acts.

Our review of information technology controls covered general and application controls. General controls are the structure, policies and procedures that apply an entity's overall computer systems. They include entitywide security management, access controls, system software controls, application software development and change controls, segregation of duties and service continuity controls. Application controls involve input, processing, and output controls related to specific IT applications.

We performed a review of the computer controls at the Hyattsville Regional Operations Center (HROC) using the *Federal Information Systems Controls Audit Manual* (FISCAM). Our review included a limited scope general controls review of the operating environments associated with the GOALS II and PACER applications using the Change Control, System Software, and Access Controls sections of the FISCAM methodology developed by GAO. We also performed a limited scope application controls reviews on the CP&R and GOALS II applications. In addition, we performed a full scope application controls review of the PACER application.

Our testing continued to identify numerous general controls weaknesses that do not effectively prevent (1) unauthorized access to and disclosure of sensitive information, (2) unauthorized changes to systems and applications software, (3) unauthorized access to programs and files that control computer hardware and secure applications, or (4) disruption of critical operations. Further our testing identified weaknesses in application controls associated with PACER. Our detailed findings and recommendations are provided in a separate limited official use management letter dated November 1, 2002. A summary of the key general controls findings and the application controls finding are as follows:

Entitywide Security Management – FMS has made great strides in the improvement of the IT controls environment during 2002. All Tier 1 applications and some Tier 2 applications were certified and accredited during the year. Risk Assessment Training was provided to all Assistant Commissioners. The FMS Entitywide Security Plan was signed off in September of 2002. However, for most of the year under audit FMS management was still in the process of implementing these changes. The true measure of their ability to successfully correct IT control deficiencies will be reflected in their ability to implement enhancements to the controls environment entitywide, on all systems and platforms in use. Our current year audit indicates that while problems were corrected in some areas, they still continued to exist in other areas. This is evidenced by the continued existence of previously identified problems in newly reviewed areas.

Access Controls – Access controls are designed to limit or detect access to computer programs, data, equipment, and facilities to protect these resources from unauthorized modification, disclosure, loss or impairment. Such controls include logical and physical security controls. Access control weaknesses we identified represented the largest problem area. We found weaknesses in the administration of access controls, access to computer programs and files, and access to sensitive data.

Service Continuity – FMS has split their Business Continuity Planning efforts into two phases. The first phase, a Business Impact Assessment is complete. FMS is in the process of incorporating the results of their Business Impact Assessment into detailed Recovery Plans, which is the second phase. However, this process had not been completed during our audit period.

Change Controls – Change controls are designed to prevent the introduction of unauthorized changes to application software programs. We found weaknesses in the enforcement of configuration management procedures related to several major applications.

System Software – System software controls are designed to prevent the introduction of unauthorized changes to systems software and to prevent their use in circumventing logical security controls. We found weaknesses in the development and enforcement of policies and procedures over usage and changes to operating system utilities and operating system upgrades.

We also noted an applications control weakness in the lack of sufficient reconciliation procedures for the interface transferring data between the Check Payment and Reconciliation System (CP&R) and PACER. This is especially important since until recently PACER was the only mechanism by which users could easily obtain some check status related data. As more fully discussed below, until September 30, 2002 FMS had not developed a methodology using CP&R for generating a detail listing of outstanding checks at a point in time.

Controls Over Outstanding Checks

FMS did not have adequate controls over the summary dollar total of outstanding checks (i.e., checks issued that have not been paid or cancelled). As a result, government-wide cash was overstated by \$3.1 billion. The following specific matters pertaining to outstanding checks were noted:

- Until recently, FMS was unable to produce a detail of outstanding checks as of a given date. Such detail is necessary to maintain an adequate audit trail over these items, and for reconciliation purposes.
- FMS did not reconcile the balance of outstanding checks in STAR (the general ledger) to the amount contained in the Check Payment and Reconciliation (CP&R) system, which records the details of check issuance and payments.

- The Check Issue Audit Reconciliation Report is used to reconcile the total of checks issued as recorded in STAR to the total contained in CP&R and identify all timing differences between the two systems. However, not all reconciling items affecting STAR were investigated and adjusted in the proper period.
- There are insufficient reconciliation procedures between CP&R and PACER, a system that contains check status related data.

The *Standards for Internal Control in the Federal Government*, which refer to cash as an asset that might be vulnerable to risk of loss or unauthorized use, states that control activities include reconciliations. Strong reconciliation controls and an adequate audit trail for outstanding checks are necessary since the computation of government-wide cash includes a reduction for the total amount of outstanding checks. If outstanding checks are understated, then cash will be overstated and vice-versa. The absence of reconciliation controls and an adequate audit trail allow misstatements to remain undetected.

To date, FMS has not been able to determine the cause of the \$3.1 billion misstatement, or when it occurred. However, FMS has determined that the understatement of outstanding checks occurred prior to September 30, 2000. Consequently, FMS corrected the misstatement by posting a prior period adjustment to increase outstanding checks by \$3.1 billion (which results in a corresponding decrease in cash) and by reducing government equity for the same amount.

Recommendations:

We recommend that FMS:

1. Develop and implement procedures for the monthly reconciliation of the STAR control balance of outstanding checks to the detail balance generated by CP&R. We recommend that FMS use the check issue audit reconciliation as the starting point for this reconciliation. We further recommend that reconciling items on this report be separated between timing differences that affect the detail and timing differences and adjustments that affect the STAR control balance. All timing differences and adjustments that affect the STAR control balance should be appropriately reviewed and posted in the proper monthly period. Procedures should include appropriate supervisory review and approval of the reconciliation process.
2. Continue to investigate the origin and cause of the imbalance by continuing the rollback of the check issue audit reconciliation to prior periods as far back as records are available. FMS management believes that this imbalance is most likely an opening balance issue that dates back many years. However, given the highly liquid nature of Government-wide cash and the ongoing general controls weaknesses, we believe that FMS management should continue to investigate this matter as far as back as records are available.

This report is intended solely for the information and use of the management of FMS, the Department of the Treasury Office of Inspector General, OMB and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Clifton Henderson LLP

Calverton, Maryland
November 1, 2002

Independent Auditor's Report On Compliance With Laws and Regulations

To the Office of Inspector General
of the Department of the Treasury and the
Commissioner of the Financial Management Service

We have audited the Schedule of Non-Entity Government-wide Cash of the U.S. Department of the Treasury's Financial Management Service (FMS), as of September 30, 2002, and have issued our report thereon dated November 1, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and applicable provisions of Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements."

The management of FMS is responsible for complying with laws and regulations applicable to Non-Entity Government-wide Cash. As part of obtaining reasonable assurance about whether the Schedule of Non-Entity Government-wide Cash is free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of schedule amounts and certain other laws and regulations specified in OMB Bulletin No. 01-02. We limited our tests of compliance to those provisions, and we did not test compliance with all laws and regulations applicable to FMS.

The results of our tests of compliance disclosed the following instance of noncompliance with the laws and regulations described in the preceding paragraph that is required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

Compliance with OMB Circulars A-127 and A-130

During our review of Information Technology controls, we identified several weaknesses which indicate noncompliance with OMB Circular A-127 "Financial Management Systems". These weaknesses are collectively considered a material weakness and are described in more detail in our report on internal control. The weaknesses include a lack of compliance with OMB Circular A-130's requirements for a comprehensive security plan, lack of necessary controls to protect information, and a lack of a fully developed and tested contingency plan.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

This report is intended solely for the information and use of the management of FMS, the Department of the Treasury Office of Inspector General, the OMB and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Clifton Henderson LLP

Calverton, Maryland
November 1, 2002

**DEPARTMENT OF THE TREASURY,
FINANCIAL MANAGEMENT SERVICE
SCHEDULES OF NON-ENTITY GOVERNMENT-WIDE CASH**
(In Thousands)

	September 30,	
	2002	2001 (restated)
Cash, Foreign Currency and Other Monetary Assets (Notes 2 and 3)	<u>\$ 81,663,617</u>	<u>\$ 50,274,702</u>

The accompanying notes are an integral part of these schedules.

**DEPARTMENT OF THE TREASURY,
FINANCIAL MANAGEMENT SERVICE
NOTES TO THE SCHEDULES OF NON-ENTITY GOVERNMENT-WIDE CASH
September 30, 2002 and 2001**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

FMS is a bureau of the U.S. Department of the Treasury (Treasury). FMS' mission is to improve the quality of the Federal government's financial management. FMS' commitment and responsibility is to help its customers achieve success. FMS does this by linking program and financial management objectives and by providing financial services, information, advice, and assistance to its customers. FMS serves taxpayers, Treasury, federal program agencies, and government policy makers.

Non-entity accounts are those accounts that FMS holds but are not available to FMS in its operations. For example, FMS accounts for certain cash that the Federal Government collects and holds on behalf of the U.S. Government or other entities. This schedule includes the non-entity Government-wide cash accounts.

Basis of Accounting

The standards used in the preparation of the accompanying schedule are issued by the Federal Accounting Standards Advisory Board (FASAB), as the body authorized to establish generally accepted accounting principles for federal government entities. Accordingly, the accompanying schedules are prepared in accordance with generally accepted accounting principles.

The accompanying schedule is different from the financial reports, prepared by FMS pursuant to OMB directives that are used to monitor and control FMS' use of budgetary resources.

Intra-governmental Financial Activities

The financial activities of FMS are affected by, and are dependent upon, those of the U.S. Department of the Treasury and the Federal Government as a whole. Thus, the accompanying schedules do not reflect the results of all financial decisions and activities applicable to FMS as if it were a stand-alone entity.

NOTE 2 – NON-ENTITY CASH, FOREIGN CURRENCY, AND OTHER MONETARY ASSETS

Non-entity cash, foreign currency, and other monetary assets include the Operating Cash of the Federal Government, managed by Treasury. Also included is foreign currency maintained by various U.S. and military disbursing offices.

**DEPARTMENT OF THE TREASURY,
FINANCIAL MANAGEMENT SERVICE
NOTES TO THE SCHEDULES OF NON-ENTITY GOVERNMENT-WIDE CASH
September 30, 2002 and 2001**

NOTE 2 – NON-ENTITY CASH, FOREIGN CURRENCY, AND OTHER MONETARY ASSETS (CONTINUED)

The Operating Cash of the Federal Government represents balances from tax collections, customs duties, other revenues, federal debt receipts, time deposits, and other various receipts net of checks outstanding, which are held in the Federal Reserve Banks (FRBs), foreign and domestic financial institutions, and in U.S. Treasury tax and loan accounts.

The Operating Cash of the Federal Government includes compensating balances, totaling \$27.4 billion as of September 30, 2002 and \$13.4 billion as of September 30, 2001. These balances are deposited interest free to compensate commercial banks for services provided on behalf of the Federal Government (such as handling over the counter deposits for federal program agencies, providing lockbox services for agency collection programs, etc.). Operating cash of the Federal Government is either insured (for balances less than \$100,000) by the Federal Deposit Insurance Corporation, or collateralized by securities pledged by the depository institutions and held by the FRBs.

NOTE 3 – PRIOR PERIOD ADJUSTMENT - CORRECTION OF OUTSTANDING CHECK BALANCE

A prior period adjustment was recorded at September 30, 2002 increasing the Federal Government's Check Liability and increasing the Excess Liabilities Over Assets of the Federal Government by \$3,101 million. The purpose of this adjustment was to bring the current balance in outstanding checks in the control accounts into agreement with the detail of outstanding checks per the subsidiary records.

The net effect of this transaction is a decrease in the overall net position of the Federal Government. The effect this adjustment has on the Treasury-wide financial statement is an increase in the Amount Due From the General Fund and a decrease in Cash, Foreign Currency, and Other Monetary Assets account.

Prior to September 30, 2002 FMS was not able to produce the detail of outstanding checks at a point in time from its subsidiary system and therefore could not reconcile the detail to the general ledger control. FMS research and reconciliation procedures determined that this error did not arise in either of the years ended September 30, 2002 or 2001. Therefore the balance of Operating Cash of the Federal Government as of September 30, 2001, as previously reported has been restated as follows (in thousands):

Balance September 30, 2001 as previously reported	\$ 53,375,875
Prior period adjustment to correct outstanding checks	<u>(3,101,173)</u>
Balance September 30, 2001 as restated	<u>\$ 50,274,702</u>

This information is an integral part of the accompanying schedules.